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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 637

NORTHEASTERN PENNSYLVANIA NATIONAL BANK & TRUST COMPANY, EXECUTOR, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the United States District Court for the Middle District of Pennsylvania (R. 17–27) is reported at 235 F. Supp. 941; the opinion of the court of appeals, sitting *en banc* (R. 38–59), is reported at 363 F. 2d 476.

JURISDICTION

The judgment of the court of appeals was entered on July 19, 1966 (R. 60). The petition for a writ of certiorari was filed on October 7, 1966, and was granted on December 5, 1966 (R. 61; 385 U.S. 967). This Court's jurisdiction rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a bequest of property in trust providing for the monthly payment of a fixed dollar amount out of income or corpus to the decedent's widow for life constitutes a bequest of "all the income from a specific portion" of the trust property within the meaning of § 2056(b)(5) of the Internal Revenue Code of 1954 so as to qualify the bequest for a marital deduction.

STATUTES AND REGULATIONS INVOLVED

The relevant portions of §2056 of the Internal Revenue Code of 1954 and of the applicable Treasury Regulations are set forth in the Appendix, *infra* pp. 37–52. The most pertinent portion of the statute, §2056(b)(5), provides that:

> [i]n the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse * * *

the entire interest or such specific portion thereof shall qualify for the marital deduction.

STATEMENT

Decedent died testate on May 3, 1958, survived by a widow and four children. His will devised one-half of the residue of his estate to petitioner as trustee of a spendthrift trust. The trust provided that his widow was to receive out of trust income, and corpus if necessary, the sum of $300 per month until the decedent's youngest child reached eighteen and thereafter $350 per month. In addition, the widow had the power to appoint by will the corpus of the trust to her estate or to named individuals. If the trust earned more income than was necessary to meet the monthly payments to the widow, the excess was to be accumulated. The trustee was also given discretionary power to invade up to $1,500 of corpus in the event of the widow's illness or financial emergency. The value of the trust corpus at the date of decedent's death was $69,246. (R. 5, 8–11.)

On decedent's estate tax return petitioner (his executor) reported an adjusted gross estate of $199,750, and claimed the maximum marital deduction of one-half of the adjusted gross estate ($99,875), since the value of property passing to the widow outright ($41,251) plus the value of the residuary trust ($69,246) exceeded one-half of the adjusted gross estate. The Commissioner determined that the trust did not qualify for the marital deduction. (R. 18–19.)

The question presented by this case is whether part or all of the $69,246 testamentary trust corpus qualifies for the estate tax marital deduction. This, in turn, depends on whether decedent's widow, in addi-

tion to having a general power of appointment over the trust corpus, was also entitled "for life to all the income from the entire interest, or *all the income from a specific portion* thereof, payable annually or at more frequent intervals." 1954 Code, § 2056(b)(5) (emphasis added).

On cross-motions for summary judgment, petitioner first argued that the widow was entitled to have *all* of the trust income paid to her, and thus that the full value of the trust corpus qualified for the deduction. The district court rejected this contention. Although at the time of trial the corpus had not yet produced an income in excess of $300 per month, the court found that the income from the trust could exceed that amount in which case the excess above $300 per month would be accumulated. (R. 22.) Hence, the court found that the trust did not meet the statutory requirement that *all* of the trust income be "payable [to the widow] annually or at more frequent intervals."

Petitioner next argued that the widow was entitled to have "all the income from a specific portion" of the trust corpus paid to her for life, and thus that a specific portion of the trust qualified for the deduction. The district court rejected the government's contention, based on the applicable Treasury Regulations, that none of the trust qualified because the widow was not entitled to a fractional or percentile share of the trust income. Instead, the court held that it could, through use of annuity valuation tables, value the widow's right to receive fixed payments and that this value constituted a "specific portion" of the trust corpus from which the widow

was entitled for life to "all the income." The court determined that the widow's right to payments was worth \$63,663 and held decedent's estate entitled to a marital deduction in this amount. (R. 17–27).[1]

The court of appeals, sitting *en banc*, reversed, three judges dissenting, holding that it was impossible to compute any specific portion of the trust corpus from which decedent's widow is entitled for life to "all the income" generated. The court reasoned that since the rate of return on the trust assets will fluctuate over the widow's lifetime, an amount of corpus which would, in one year, produce \$3,600 of income would, in other years, produce either more or less income. Therefore, no method of computation can isolate a "specific portion" of the trust corpus from which the widow will receive "all the income" actually produced, and the trust thus does not qualify for the deduction. (R. 38–59.)

SUMMARY OF ARGUMENT

In 1948, Congress enacted the marital deduction provisions of the Internal Revenue Code to equalize the effect of estate taxes in community property and common law jurisdictions. In community property jurisdictions a decedent's estate includes only one-half of the community property and his widow's

[1] The calculation was based on the annuity valuation tables contained in § 20.2031–7 of the Estate Tax Regulations. On the basis of an assumed interest yield of 3½ percent, the value of an annuity of \$300 per month to decedent's widow is \$63,603.43. The district court's finding of \$63,663.43 is based on an erroneous stipulation by the parties regarding the calculation and does not affect the amount of tax in dispute.

estate includes the other half. In order to approximate these estate tax consequences in common law States, Congress in 1948 granted a marital deduction to the estate of a decendent in a common law jurisdiction—of up to one-half of the adjusted gross estate—for property that passes to his surviving spouse. Since the widow in a community property State is the outright owner of one-half the community property, Congress required that an interest in property bequeathed to a widow in a common law State must be the equivalent of outright ownership in order to qualify for the deduction. Thus, if the decedent bequeaths to his wife an interest less than virtual ownership, such as a life interest (with remainder to another), the bequest does not qualify for a deduction.

Recognizing, however, that bequests of property in trust were "one of the customary modes of transfer in common law states," Congress granted the deduction where the decedent established a trust for his widow and gave her (1) the right to receive all the income annually or at more frequent intervals and (2) the power to appoint the entire corpus to herself or her estate. In enacting this provision Congress noted that where the widow had these rights, she was for practical purposes the "virtual owner" of the trust property, since her income would rise and fall as the trust's income fluctuated and the value of the assets subject to the widow's power of appointment would rise and fall with the value of trust assets.

Since the 1948 legislation required the widow to receive all of the income from the entire trust if it was to qualify for the deduction, a decedent was forced to establish two trusts if he wished to leave his property in trust for the benefit of both his children and his wife. Recognizing that this requirement served no valid purpose, Congress amended the marital deduction provision in 1954 to provide that a bequest of less than all the income from a trust could qualify for the deduction if the widow received "all the income" from a "specific portion" of the trust plus a general power of appointment over either that specific portion or all of the trust assets. The legislative history confirms that this change was not intended to alter the basic requirement that if a bequest in trust is to qualify, the widow must have the rights of a virtual owner (including the right to receive all of the income from either all or a specific portion of the trust corpus).

In view of the congressional intent to grant the deduction only to interests amounting to virtual ownership and the implementing statutory requirement that "all the income" from a "specific portion" of the trust property be payable to the widow, the Treasury promulgated Regulations in 1958 providing that a partial interest in a trust's income could qualify only if the widow was receiving a fractional or percentile share of the trust income, or its equivalent. The Commissioner reasoned that only in these circumstances will the widow be the virtual owner of,

and be receiving "all the income" generated by, a "specific portion" of the trust corpus.[2]

If the widow is bequeathed one-half of the income generated by the trust corpus, it is clear that she will receive all the income from one-half of the trust assets whatever the variations in their yield. On the other hand, where the surviving spouse is given a fixed amount of income (such as $300 per month), it is impossible to determine at the time of the decedent's death any "specific portion" of trust assets from which the widow will receive "all the income" generated by those assets, for as the yield of the trust assets varies, the portion of the trust assets necessary to produce the fixed amount of income will vary. For example, if the surviving spouse were entitled to receive $4,000 per year, it would require $100,000 of trust corpus at a yield of four percent to produce the annual payment. If the yield then rose to five percent in a subsequent year, the widow would be receiving "all the income" from only $80,000 of corpus. Therefore, if the widow is bequeathed fixed payments and if, as here, the yield of the trust will vary, there is no way to isolate any specific portion of the trust corpus from which she will (like a "virtual owner" of a specific portion of the trust property) receive all the income actually generated, as the statute requires. Accordingly, the Regulations, in requiring that the widow's

[2] Other language in § 2056(b)(5) and the Regulations thereunder allows a deduction where the widow is given all the income from, and a general power of appointment over, a specific item of trust property (such as a piece of commercial realty).

income interest be cast in terms of a fractional share or its equivalent, manifestly carry out Congress' intent that the widow must be the "virtual owner" of a "specific portion" of the trust property in order for a marital deduction to be allowable.

Some lower courts have disapproved the Regulations on the ground that although, as here, the income and value of the trust's assets will fluctuate, the value of the widow's right to receive fixed payments can be computed and this value can be considered a specific portion of the trust corpus. Aside from the fact that the two methods of valuation which have been used—one based on an annuity and the other on a capitalization computation—produce markedly different results, treating an artificially computed value as a "specific portion" of trust assets is improper for two basic reasons. First, it assumes that whether a bequest in trust qualifies for the marital deduction turns solely on whether it can be valued. Under § 2056(b), however, a bequest can qualify only if it has the characteristics of virtual ownership required by the statute, *i.e.,* only if the widow will actually receive "all the income" generated by a specific portion of the corpus. Second, these computational techniques are based on various artificial assumptions, including the assumption that the corpus will have an unvarying yield of 3½ percent. Because these computations assume—contrary to fact—that the trust will earn a fixed constant yield, they cannot serve to isolate as of the date of decedent's death (when qualification for the deduction must be determined) a specific portion of variable yield trust assets from which the widow will receive all the income actually pro-

duced. To permit a deduction because a widow's right to receive fixed periodic payments can be valued by arbitrarily assuming a constant hypothetical yield would effectively read out of the statute the explicit requirement that the widow receive "all the income from a specific portion" of the trust assets.

When, as here, the value and income of the trust assets can vary, only an interest in trust income expressed as a fractional share or its equivalent, together with a power of appointment over such share of the corpus, can isolate a specific portion of the trust from which the widow is entitled to "all the income" and over which she has the power of disposition, as the statute requires. The Regulations should therefore be upheld.

ARGUMENT

I

IN ORDER TO EQUALIZE THE ESTATE TAX BURDEN IN COMMON LAW AND COMMUNITY PROPERTY STATES, CONGRESS GRANTED A MARITAL DEDUCTION TO A DECEDENT IN A COMMON LAW STATE WHO MADE HIS WIDOW THE "VIRTUAL OWNER" OF PROPERTY HELD IN TRUST

Congress first enacted the marital deduction provision in 1948[3] in order "to equalize the effect of the estate taxes in community property and common-law jurisdictions." *United States* v. *Stapf*, 375 U.S. 118, 128; see also *Jackson* v. *United States*, 376 U.S. 503, 510. Under a community property system, a married

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[3] Section 361 of the Revenue Act of 1948, c. 168, 62 Stat. 117, amending § 812 of the Internal Revenue Code of 1939.

person owns—and thus his estate includes—only one-half of the community property, the other half belonging to his surviving spouse. In order to approximate this result in common law States, Congress granted a marital deduction—of up to one-half of the adjusted gross estate—for property that passes from the decedent to his surviving spouse. Since in community property States the widow owns one-half of the community property outright,[4] Congress required that the interest passing from a decedent to his widow in a common law State must be equivalent to absolute ownership, if it is to qualify for the marital deduction.[5]

Consistent with its objective of equalizing the tax treatment of residents of common law and community property States, Congress refused to allow any marital deduction where the decedent gave his wife substantially less rights than she would have had in community property. For example, if decedent gave his wife only a life interest, or if her interest would terminate upon remarriage, and the remainder then pass to someone else, the bequest would not qualify for the deduction. (See § 2056 (b)(1) (App. *infra,* p. 37), denying any marital deduction where a decedent bequeaths a "terminable interest" to his widow.)

Congress, however, recognized that bequests of

[4] *E.g.*, Arizona Revised Statutes, § 14–203; California Probate Code, § 201; Louisiana Civil Code, Article 2406; Texas Probate Code, § 45.

[5] Community property, of course, does not qualify for the marital deduction. § 2056(c)(2). (Unless otherwise indicated references are to the 1954 Code.)

property in trust were "one of the customary mode of transfer of property in common-law States"[6] and thus in the original 1948 legislation it specifically granted a marital deduction where the decedent creates a trust and the "surviving spouse is entitled for life to *all the income* from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus" to herself or her estate.[7] In such a case, since the widow was entitled to receive currently "all the income" from the trust, she would receive the benefit or burden of any increase or decrease in the trust's income. Similarly, since she had the power "to appoint the entire corpus" to herself or her estate, any increase or decrease in the value of the trust assets would be directly reflected in the amount of property over which she had a power of disposition. In these two important respects she was in exactly the same position as if she had owned the property outright. Congress decided that, where she had these key incidents of ownership, the estate should be entitled to the marital deduction because the surviving widow was for practical purposes "the virtual owner of the property." S. Rep. No. 1013, Part 2, 80th Cong., 2d Sess., p. 16 (1948-1 Cum. Bull. 331, 342).

Thus, under the original 1948 legislation creating the marital deduction, if a decedent left one-half of

[6] S. Rep. No. 1013, 80th Cong., 2d Sess., p. 28 (1948-1 Cum. Bull. 285, 305).

[7] 1939 Code, § 812(e)(1)(F), as added by § 361 of the Revenue Act of 1948, c. 168, 62 Stat. 117 (emphasis added).

his property in one trust for the exclusive benefit of his widow—giving her all the income from this trust and a general power of appointment over the corpus—and the other one-half of his property in another trust for his children, he was entitled to a marital deduction with respect to the first trust. If a decedent left all of his property in a single trust, however, giving his widow one half of the income and a general power of appointment over one-half of the corpus, his estate would not be entitled to any marital deduction, because his widow neither received "all the income from the corpus of the trust" nor had a general power "to appoint the entire corpus."[8] This result followed even though the widow's rights would be substantially the same as if the decedent had created two trusts—she would receive one-half of the income from his estate and have a general power of appointment over one-half of his estate. In either event, her income would rise and fall as the income from the trust increased or decreased, and the amount of property over which she had a power of disposition would fluctuate as the value of the trust assets increased or decreased.

Recognizing that there was no good reason to require a decedent to create two separate trusts, Congress in 1954 revised the marital deduction provision

[8] See *Estate of Shedd* v. *Commissioner*, 237 F. 2d 345 (C.A. 9), certiorari denied, 352 U.S. 1024; *Estate of Sweet* v. *Commissioner*, 234 F. 2d 401 (C.A. 10), certiorari denied, 352 U.S. 878; *Estate of Hoffenberg* v. *Commissioner*, 22 T.C. 1185, affirmed, 223 F. 2d 470 (C.A. 2); *Estate of Stallworth* v. *Commissioner*, 260 F. 2d 760 (C.A. 5); Cf. *Estate of Joseph A. Barry, Sr.* v. *Commissioner* (decided April 27, 1956) 15 T.C.M. 502.

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to allow such deduction where the decedent gave his widow "all the income from the entire interest, or *all the income from a specific portion thereof*" plus a general power "to appoint the entire interest, or such specific portion." 1954 Code, § 2056(b)(5) (emphasis supplied).[9] This statutory change removed the necessity for creating two separate trusts; it did not, however, relax the requirement that the widow must be "the virtual owner of the property," *i.e.*, that the amount of her income and the amount of property covered by her power of appointment must depend directly on the trust's actual income and the value of its assets. By this revision Congress intended to allow a marital deduction if the widow became the virtual owner of "an undivided part of the [trust] property." H. Rep. No. 1337, 83d Cong., 2d Sess., p. 92; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 125. The Committee Reports give this example: "[I]f the decedent in his will provided for the creation of a trust under the terms of which the income from one-half of the trust property is payable to this surviving spouse with uncontrolled power in the spouse to appoint such one-half of the trust property by will, such interest will qualify as an exception for the terminable interest rule." H. Rep. No. 1337, 83d Cong., 2d Sess., p. A319; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 475.

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[9] Congress in 1958 made this 1954 amendment retroactive to the original enactment of the marital deduction provision in 1948. Technical Amendments Act of 1958, § 93, P.L. 85-866, 72 Stat. 1668.

II

THE REGULATIONS RECOGNIZE, AS DID CONGRESS, THAT A WIDOW IS NOT THE "VIRTUAL OWNER" OF PROPERTY UNLESS (LIKE A WIDOW IN A COMMUNITY PROPERTY STATE) HER INCOME RISES AND FALLS WITH THE TRUST'S INCOME, AND THUS THAT NO DEDUCTION IS ALLOWABLE WHERE THE WIDOW IS MERELY ENTITLED TO FIXED PAYMENTS OF INCOME

In order to implement the Congressional objective of permitting a marital deduction where the widow's partial interest in the trust corpus amounts to virtual ownership, the Treasury promulgated Regulations [10] providing that the widow is entitled to "all the income from a specific portion" of a trust only if she receives a "fractional or percentile share" of the trust income or its "equivalent," since only an interest of this

[10] § 20.2056(b)–5(c) of Treasury Regulations (1954 Code) reads in part as follows:

"A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the surviving spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown

kind carries with it a participation in income fluctuations that is a hallmark of property ownership.[11]

If the surviving spouse is given all the income from, and a general power of appointment over, one-half of the trust corpus, the precise portion of the corpus from which she will receive all the income actually produced during her lifetime and over which she will have a power of disposition can be readily isolated. This portion will qualify for the deduction because thenceforth the widow will participate in income and value fluctuations as an owner would. Where, however, as in the instant case, the widow is given the right to receive only a fixed monthly payment from a trust with variable income, she will not receive "all the income from a specific portion" of the trust because, as the trust's income varies, the amount of trust assets required to produce the fixed monthly income will also vary. For example, if a testamentary trust provided that the surviving spouse was to receive $4,000 annually, it would require $100,000 of

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that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage."

[11] Similarly, it is also clear that if the trust corpus includes a specific item of property (*e.g.*, a commercial building or a block of AT&T shares), the widow is to receive all of the income generated by this property, and she also has a general power of appointment over the specific item of property, the bequest will qualify for the deduction, since the widow is entitled to all of the income from and a power of appointment over the entire interest in the particular item of property. Treasury Regulations (1954 Code), § 20.2056(b)-5(d) (App. infra, p. 44). Prior to the 1954 version, such a bequest would not have qualified for a deduction. 1939 Code, § 812(e)(1)(F).

trust assets at an assumed four percent yield to produce the necessary income. If the yield should rise the following year to five percent, the widow would be receiving the income generated by only $80,000 of trust assets. Thus, had the value of the marital deduction been computed on the basis of an assumed four percent yield, an increase in the yield would mean that the widow was not receiving for her life all the income from a part of the $100,000 of corpus which had qualified for the marital deduction.

The Regulations recognize, however, that qualification for the deduction does not necessarily turn upon using the terminology of fractional or percentile interest; all that is required is that the interest be the "equivalent" of a fractional share. The Regulations give the example of a widow who was given the income from, and a power of appointment over, 100 out of 250 shares of stock held in trust, and explains that her interest would qualify for the deduction if she was entitled under local law to share proportionately in stock splits, stock dividends, distributions of capital, etc., for in that event she would be the virtual owner of those 100 shares, *i.e.*, her income would fluctuate as the income of the 100 shares rose and fell and the value of the property she could appoint would fluctuate with the value of the 100 shares.

Another example of a bequest that is "equivalent" to a fractional share is a devise of a fixed amount of income from a trust whose income cannot vary. For example, if a testator established a trust of fixed-yield assets, such as government bonds or notes, with a

face value of \$100,000 and a yield of \$4,000 a year, and provided that his spouse was to receive \$2,000 per year with the testamentary power to appoint all of the trust, it would be clear that the widow would, under these limited circumstances, be receiving all of the actual income from \$50,000 (*i.e.,* the equivalent of one-half) of the corpus and that amount would qualify for the deduction.[12]

Closely paralleling Code § 2056(b)(5) is § 2056(b)(6) which grants a marital deduction when proceeds of a life insurance, endowment or annuity contract are to be retained by the insurance company, which agrees to pay interest on the principal amount of the policy (or a portion thereof) to the widow during her life at a fixed rate and she has a general power to appoint the principal amount (or a portion thereof) at her death.[13] This section also utilizes the "specific portion" concept, and, contrary to the petitioner's suggestion (Br. 25), does not relax the requirement that the widow have a fractional share or its equivalent. In virtually all cases where insurance proceeds are left with the insurer, the insurance contract provides for the payment to the beneficiary of a fixed monthly sum computed on the basis of a fixed yield. Assume, for example, that the decendent left the

[12] We are assuming that the trustee cannot alter the corpus of the trust and that at the maturity date of the notes, the trust will terminate and the corpus will be paid to the widow. In such a case, the income of the trust will not vary.

[13] One variation is for the insurer to agree to pay the widow periodic installments for her life consisting of both interest at a fixed rate and principal and for her to have a general power to appoint the principal remaining at her death.

proceeds of a $100,000 insurance policy with the company, which was obligated to pay the widow $4,000 a year (as interest) during her life and, at her death, to pay the $100,000 principal amount as she designated. The effect of such an arrangement is to impose upon the insurance company, as a debtor, the obligation to make fixed interest payments as compensation for the use of the money during the widow's life. In that situation the widow, unlike the beneficiary of a variable yield trust, has no interest in, or right to, any undivided portion of the total income or assets of the insurance company; her only right is to received fixed interest payments during her life and to appoint the principal amount. Thus, if, in the example above, the widow had the right to $2,000 of the annual interest payments and the right to appoint $50,000 at her death, she in fact will receive a "specific portion" (one half) of "all" the income which the insurance company is obligated to pay the decendent's beneficiaries, as well as the right to appoint a "specific portion" (one half) of the entire proceeds. For neither the amount of such income nor the value of what she can appoint at her death can vary during her life. Thus, the Regulations provide:

> The principles set forth in Paragraph (c) of § 20.2056(b)–5 for determining what constitutes a "specific portion of the entire interest" for the purpose of section 2056(b)(5) are applicable in determining what constitutes a "specific portion of all such amounts" for the purpose of section 2056(b)(6). However, the interest in the proceeds passing to the surviving spouse will not be disqualified by the fact that the installment payments or interest to which

> the spouse is entitled or the amount of the proceeds over which the power of appointment is exercisable may be expressed in terms of a specific sum rather than a fraction or a percentage of the proceeds *provided* it is shown that such sums are a definite or *fixed percentage* or *fraction* of the total proceeds. [Emphasis supplied.][14]

Thus the consistent pattern of the marital deduction Regulations is to require that the widow receive a fractional or percentile share of the income produced by the underlying property or the equivalent thereof.[15] Unless the widow receives such an interest, it is impossible to identify a "specific portion" of the corpus from which she will receive "all the income" generated, as the statute requires and as an owner of such portion would. There can be no doubt that these Regulations carry out Congress' intent in enacting § 2056(b)(5) and (6), and they should therefore be upheld. See *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501; *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378. As a contemporaneous construction of the statute by those who were charged with "setting [the] machinery in motion," the Regulations are entitled to "peculiar weight." *Norwegian Nitrogen Products Co.* v. *United States*, 288 U.S. 294, 315. This is especially true when the subject matter is technical and complex and the interpretation is supported by a specific example in the committee re-

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[14] Treas. Regs. § 20.2056(b)-6(c).

[15] Or, as discussed *supra* fn. 11, p. 16, all of the income generated by a specific item of property.

ports accompanying the statute. See *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 102; *United States* v. *Stapf*, 375 U.S. 118, 126, 127, fn. 11.[16]

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[16] Our interpretation of the Regulations is also supported by subsequent congressional action. On September 2, 1958, Congress amended § 812(e)(1)(F) of the 1939 Code in order to make the 1954 revision (which added the language here in dispute) retroactive to the original enactment of the marital deduction provision in 1948. Technical Amendments Act of 1958, § 93, P.L. 85-866, 72 Stat. 1668. Since the Regulations here in question had first been proposed on October 16, 1956 (21 Fed. Register, part 7, pp. 7850, 7917), and finally adopted on June 16, 1958 (23 Fed. Register, part 4, p. 4529; see also T.D. 6296, 1958-2 Cum. Bull. 432, 572, 624), the Treasury's interpretation of the statutory phrase "all the income from a specific portion" had been known for almost two years prior to the 1958 amendment. If Congress had been dissatisfied with this interpretation, one would expect it to have so indicated at the time it retroactively amended the 1939 Code. Instead, it used the same language in the committee reports accompanying the 1958 amendment (including a specific example of a fractional share) that it used in the committee reports accompanying the 1954 legislation. S. Rep. 1983, 85th Cong., 2d Sess., pp. 107, 241. Moreover, the Treasury has consistently adhered to this interpretation of § 2056(b)(5) for more than ten years.

III

WHERE A WIDOW IS ENTITLED TO A FIXED AMOUNT OF INCOME FROM A TRUST WITH A VARIABLE INCOME, THERE IS NO METHOD FOR ISOLATING ANY "SPECIFIC PORTION" OF THE TRUST ASSETS FROM WHICH SHE IS ENTITLED TO "ALL THE INCOME" ACTUALLY GENERATED, AS REQUIRED BY § 2056(b)(5)

Some courts have disapproved the Regulations on the ground that although, as is true here, the trust income will vary, fixed payments bequeathed to the widow can be valued. Since they can be valued, these courts have reasoned that such value can be considered a "specific portion" under §2056(b)(5). This approach is also reflected in petitioner's contention that "because the marital deduction is taken only once, at the death of the testator, * * * we can only concern ourselves with what is its value and not with what will happen." (Br. 26.)

The basic flaw in this analysis is its assumption that valuation is the touchstone for qualification, so that any income interest plus power of appointment will qualify for the deduction, when, in fact, the gift to the widow can qualify only if it has the characteristics of virtual ownership required by the statute. If the interest does qualify, valuation is, of course, necessary since the deduction is limited to that amount. The question here, however, is whether—under the tests of §2056(b), which are designed to implement the requirement that the widow receive an interest amounting to virtual ownership—the interest qualifies for the marital deduction at all, whatever its value may be.

It is clear that § 2056(b) requires an examination of what may actually happen after decedent's death in order to determine whether the interest is a non-deductible terminable interest. For example, if the interest given to the widow may terminate at or before her death and the property pass to another, it does not qualify, although it can be valued. See § 2056(b) (1) and (2). Turning to the instant case, it is apparent that the actual income of the trust will fluctuate—perhaps markedly—during the widow's lifetime, but that, regardless of whether the income rises well above or falls substantially below $3,600 per year, the widow's income will remain constant. Therefore, she will not receive "all the income" generated by the trust or by any "specific portion" of the trust, and she does not have an interest equivalent to "virtual ownership" of any specific portion of the assets. As the court below held, where, as in the present case, the trust income is variable and the widow is entitled to fixed payments, no computational technique can isolate or identify a specific portion of the corpus from which she will receive all the income generated.

The two lower courts which have rejected the government's argument have used two markedly different computational methods in an effort to value the widow's rights to fixed payments.[17] Under one such method—the annuity approach—the court computes the amount of corpus that is necessary in order to

[17] The district court in the instant case and the Seventh Circuit in *Citizens National Bank of Evansville* v. *United States*, 359 F. 2d 817, government's petition for certiorari pending, No. 488, this Term.

make the fixed periodic payments (*e.g.,* $300 per month) throughout the widow's life expectancy, using both income earned at an arbitrarily assumed yield and corpus to make the payments, so that at the end of the period the corpus will theoretically be exhausted. Under the other method—the capitalization approach—the court computes the amount of corpus that is necessary in order to earn—at an arbitrarily assumed yield—an amount of income equal to the fixed periodic payments, so that the corpus will theoretically never be exhausted or diminished. The results of these two methods are strikingly different.

In this case, for example, the district court used the annuity method, employing the annuity valuation tables contained in §20.2031-7 of the Estate Tax Regulations to compute the value of the widow's rights.[18] Although this Regulation is extremely useful in resolving the difficult valuation problems which exist when an annuity is includible in an estate, it is, as the court below concluded, totally inappropriate for determining a specific portion of the trust from which all of the income is payable to the widow.

Although the statute clearly requires as a prerequisite to deductibility that the widow have the right to receive all the income actually produced by a specific portion of the trust assets for her actual lifetime so that her interest really is the equivalent of ownership, the annuity tables assume a constant yield of 3½ percent, an actuarially determined life expectancy for the widow, and exhaustion of the corpus over that

[18] See fn. 1, *supra*, p. 5.

period. Such assumptions must, of necessity, be made when it is necessary to value an annuity, but they should not be used here, since Congress has granted a marital deduction only if the decedent's will has actually given his widow the right to receive for her life all of the income actually generated by some specific portion of the trust assets. Furthermore, introducing the factor of actuarially determined life expectancy means that the size of the marital deduction will depend upon the widow's age—the younger the widow, the larger the estate's marital deduction will be—a result for which the statute provides no inkling of support. Finally, since §2056(b)(1)(C) specifically provides that a direction in a decedent's will that his executor or trustee use a bequest of funds to purchase an annuity for his wife disqualifies the bequest for the marital deduction, it is anomalous to compute the "specific portion" as if that were just what the trustee had been directed to do.

The other computational method—the capitalization approach, which was approved of by the Seventh Circuit in *Citizens National Bank of Evansville* v. *United States,* 359 F. 2d 817, government's petition for a writ of certiorari pending, No. 488, this Term—is equally unsatisfactory. The facts in *Citizens National Bank* are substantially the same as in the instant case. The decedent had created a residuary testamentary trust worth $123,000 which provided that his widow was to receive $200 per month for the first five years after his death, and thereafter all of the income from the trust, with power to appoint all

of the trust property at her death. The court of appeals upheld the district court's determination that $68,572 of the trust qualified for the marital deduction since that was the capitalized amount of corpus necessary to produce an income of $200 per month assuming a 3½ percent annual yield (*i.e.*, $68,572 × 3½ percent = $2,400 per year). Although the capitalization approach does not involve artificial assumptions with respect to corpus dissipation and the widow's life expectancy (which are required by the annuity method), the capitalization technique is, nevertheless, no more appropriate than the annuity approach for isolating a specific portion of variable yield assets from which the widow is entitled to receive all the actual income. For the capitalization technique, like the annuity method used by the district court in the instant case, arbitrarily assumes that the trust assets will produce a fixed annual yield (*e.g.*, 3½ percent in the *Citizens Bank* case), which will remain constant over the widow's lifetime. Both of these assumptions are almost sure to be contrary to the actual facts. In any year in which the yield is greater than 3½ percent, the widow will not receive all the income generated by the $68,572 of corpus for which the deduction was granted.[19]

[19] *Tomec* v. *Commissioner*, 40 T.C. 134, heavily relied upon by petitioner (Br. 23-24), deals with the question of the proper valuation of property includible in the decedent's gross estate under § 2036 because she had retained a partial life interest therein. The question here presented is not the value of the widow's right to fixed payments but whether she was given all the income generated by a specific portion of the trust assets. **(Cont'd)**

The defects inherent in these computational methods are highlighted by the markedly diverse results they produce. If a decedent dies leaving a $300,000 trust from which his widow is to receive $300 a month, the capitalization method adopted by the Seventh Circuit in *Citizens National Bank* would produce a specific portion of $102,806, and the actuarial method used by the district court in this case would produce a marital deduction of $64,706 if the widow were 40 years old, and a deduction of $40,813 if she were 60 years old.

IV

PETITIONER'S ARGUMENTS TO THE CONTRARY ARE WITHOUT MERIT

1. In arguing that the Regulations are invalid, petitioner relies on *Gelb* v. *Commissioner*, 298 F. 2d 544 (C.A. 2). In *Gelb*, the decedent had established a residuary testamentary trust in which his widow was entitled to all the income for her life with a general power of appointment over the corpus. The will also gave the trustees discretionary power to invade corpus up to $5,000 per year for the support, maintenance and education of the decedent's youngest daughter. Since the widow was entitled to all of the income from the entire trust, the bequest met the § 2056(b)(5) requirement regarding income. The Commissioner contended, however, that the widow did not possess the requisite power of appointment be-

Use of an assumed yield of 3½ percent to solve valuation problems under § 2036 in no way justifies computing a specific portion under § 2056(b)(5) on the basis of an assumed rather than the actual income of the corpus.

cause the trustees' power to invade corpus in favor of the youngest daughter meant that the widow did not have the power to appoint either the entire corpus or a specific portion thereof. The Second Circuit held that, because of the trustees' power to invade corpus, the widow did not have a power of appointment over the entire trust, but that she did have a power of appointment over a specific portion of the corpus which could be computed by subtracting from the full value of the trust corpus the maximum amount of corpus which the trustees could reasonably be expected to pay to or for the daughter. The court disapproved Regulation 105, § 81.47(a)(c)(3) (now Regulation § 20.2056(b)–5(c)), to the extent that "it would limit a 'specific portion' to 'a fractional or percentile share.'" 298 F. 2d at 551.

As the Third Circuit noted in the instant case, *Gelb* is distinguishable from this case because the question in *Gelb* was whether there was an identifiable minimum portion of the corpus over which the widow had a power of appointment. The maximum amount which could be withdrawn annually for the daughter in *Gelb* was $5,000. Multiplying this figure by the sole variable—the life expectancies of the widow and daughter—produced the maximum amount which could be expected to be diverted to the daughter and, conversely, the minimum amount which the widow could reasonably be expected to have the power to appoint. There was no question in *Gelb* as to whether the widow had the requisite right to income,

since she was entitled to receive all the income produced by the trust.

In the instant case, however, the widow has the right to receive fixed income payments from a trust with fluctuating income. It is thus impossible to compute even a minimum specific portion of trust corpus, all of the income from which is payable to the widow, because each computation depends upon an arbitrary assumption as to the yield of the trust assets, and there is no way of knowing in advance the actual income yield of trust assets, unless the trust is restricted to owning solely fixed-yield assets. Therefore, even if the *Gelb* result is accepted, it does not control the question presented by this case.

Although it is thus distinguishable, we believe that *Gelb* was wrongly decided for two reasons. First, like the reasoning of the district court in this case and the Seventh Circuit in *Citizens National Bank*, *Gelb* is based on the fallacious assumption that if the widow's interest can be valued, that value will qualify for the marital deduction. As discussed, *supra*, p. 22, quite the contrary is true. Whatever the value of the interest bequeathed to the widow, it can qualify for the marital deduction only if it has the characteristics of virtual ownership required by the statute.

Second, the court erroneously assumed that if the widow had a power of appointment over a fixed dollar amount of corpus, that figure could be considered a "specific portion" and would, therefore, qualify for

the deduction.[20] However, when, as in *Gelb,* the corpus can fluctuate in value, the power to appoint a fixed dollar amount of corpus is not the equivalent of virtual ownership of a specific portion of trust assets, since the surviving spouse does not share in fluctuations in the value of the trust assets. Furthermore, the approach of the *Gelb* court would give residents of common law jurisdictions a significant advantage over residents of community property States.

Assume, for example, that a husband in a common-law State left his entire estate worth $200,000 in trust and gave his widow all of the trust income for her life plus a testamentary general power to appoint $100,000 of corpus (the remaining corpus being payable to the children). Assume also that before the widow's death, the trust corpus increased in value from $200,000 to $600,000 and that the widow exercised her power of appointment in favor of the children. In such a case, the *Gelb* court's approach would allow the husband's estate a $100,000 marital deduction with the result that only $100,000 is included in the husband's estate and $100,000 in his widow's estate (*i.e.,* the maximum amount of assets subject to her general power of appointment). Thus, $600,000 would pass to the children but only $200,000 would have been subject to an estate tax.

[20] See *Allen* v. *United States*, 250 F. Supp. 155, 157 (E.D. Mo.); cf. *Flesher* v. *United States*, 238 F. Supp. 119, 124 (N.D. W. Va.).

However, if the same situation had arisen in a community property State, decedent and his wife would each have owned one-half the property outright. Thus, if the husband died and bequeathed his one-half interest in the community property in trust, the income payable to his wife for life, remainder to his children, his estate would, like the estate of the common law resident, include $100,000. When his wife dies leaving her one-half interest in the community property to her children, her estate will include one-half the value of the property at the time of her death—$300,000. Since the widow in a community property State has outright ownership of one-half the community property, she is taxable on one half of its appreciated value.

The result in both cases is that $600,000 passes to the children, but in a community property State $400,000 is subject to tax, while, if the *Gelb* rationale is accepted, only $200,000 would be subject to tax in a common law State. Thus, although the congressional purpose in enacting the marital deduction was to give estates in common law jurisdictions comparable tax treatment to those in community property States, the effect of the *Gelb* rule is to give them more favorable treatment. This discrepancy would be avoided if a decendent in a common law State, in order to obtain a marital deduction, were required to give his widow a fractional share of the corpus (in this case one-half), for then the value of the assets subject to her power of appointment would rise with the value of the trust as-

sets, so that the appreciated value of the assets subject to her power would be included in her estate.[21]

Therefore, the Regulations here in question correctly implement congressional intent when they require, in order for a deduction to be allowed, that the bequest to the widow must be a fractional share or its equivalent, so that the widow's income rises and falls as the trust's income fluctuates and the value of the assets subject to her power of appointment rises and falls as the value of the trust assets fluctuates, *i.e.*, the Regulations correctly require the widow in a com-

[21] It is clear that comparability in estate tax consequences between common law and community property jurisdictions can be achieved only by requiring that a specific portion be cast in terms of a fractional interest or its equivalent. Using the examples stated in the text, in which the property passing to the children was worth $200,000 at the death of the husband and $600,000 at the death of the widow, the estate tax results may be summarized as follows:

Results under—	Amount subject to tax on husband's death	Amount subject to tax on widow's death
Community property State	$100,000	$300,000
Common law State—fracional share	100,000	300,000
Common law State—*Gelb* rule	100,000	100,000

Moreover, if the value of the property passing to the children *decreased* from $200,000 at the husband's death to $100,000 at the widow's death, comparability again is achieved only by requiring the widow to receive a fractional interest:

Results under—	Amount subject to tax on husband's death	Amount subject to tax on widow's death
Community property State	$100,000	$50,000
Common law State—fractional share	100,000	50,000
Common law State—*Gelb* rule	100,000	100,000

mon law State to be the "virtual owner" of a specific portion of the trust assets as the widow in a community property State would be.

2. Petitioner also argues that since the widow in the instant case is the trust's only beneficiary, she must be "the virtual owner of the trust as contemplated by Congress" (Br. 20). Congress has, however, set forth the attributes of virtual ownership, all of which must be present in order for the trust to qualify. One of those attributes is that the income must be payable to the widow "annually or at more frequent intervals." § 2056(b)(5). Thus, if a trust instrument (1) provides that the income is to be accumulated for ten years, that the accumulated income is then to be paid to the widow, and that the income is thereafter to be paid to her currently, and (2) grants the widow a testamentary general power of appointment over the corpus, the trust clearly does not qualify for the marital deduction, even though the widow is the only beneficiary of the trust. In this case, the district court found that the trust could earn income in excess of that required to meet the $300 monthly payments to the widow and that such excess would be accumulated (R. 22). In these circumstances, the trust cannot qualify for the deduction even though the widow will either ultimately receive or have a power of appointment over all the income.

3. Finally, petitioner argues that so long as the property will be included in the estate of the widow at her death and subjected to taxation at that time, the trust should qualify for the deduction. (Br. 12, 26–27.) If Congress had intended to grant a marital

deduction whenever assets in trust would be included in the widow's gross estate, then § 2056(b)(5) would have provided such a deduction whenever the decedent established a trust and gave his widow only a general power of appointment over the corpus. (§ 2041 provides that property subject to a person's general power of appointment will be included in the power holder's estate.) However, § 2056(b)(5) grants a marital deduction for trust assets only when the decedent has given his surviving spouse both a general power of appointment and the requisite income interest so that she will be the virtual owner of the property, like the widow in a community property State. As this Court stated in *Jackson* v. *United States, supra,* p. 510, "the determinative factor [as to deductibility] is not taxability to the surviving spouse but terminability as defined by the statute."

In summary, it may be appealing to use some computational technique based on arbitrary assumptions as to yield, life expectancies, etc., in order to estimate the value of a widow's right to receive fixed payments out of income or corpus and then to use this estimate as a "specific portion" of the corpus that will qualify for the deduction. However, such attempts fly squarely in the face of the Code requirement that the surviving spouse actually receive all the income of a specific portion—a requirement compelled by the congressional purpose of achieving uniform federal estate tax consequences in common law and community property States by insuring that only an in-

terest equivalent to outright ownership should qualify for the marital deduction.

Indeed, petitioner's argument would in effect write out of the statute the requirement that the surviving spouse must receive "all the income" from at least a "specific portion" of the property. For it always is possible, by using arbitrarily assumed yields or life expectancies, to calculate that portion of the property which, on the basis of such assumptions, will produce the designated dollar payments. But Congress could not have intended the courts to interpret the statutory phrase "all the income from a specific portion" so as to deprive it of any meaningful content. On the contrary, the correct interpretation of the statute is that contained in the Regulations—that "specific portion" means a fractional or percentile interest or its equivalent, and not an arbitrarily computed amount whose sole justification is that it will theoretically produce periodic income equal to the fixed payments required by the will.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) *Allowance of Marital Deduction.*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) *Limitation in the Case of Life Estate or Other Terminable Interest.*—

(1) *General rule.*—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

* * * * *

(5) *Life estate with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(6) *Life insurance or annuity payments with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts, or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse—

(A) such amounts shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of such amounts shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if, under the terms of the contract, such power in the surviving spouse to appoint such amounts, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(c) *Limitation on Aggregate of Deductions.*—

(1) *General rule.*—The aggregate amount of the deductions allowed under this section (computed without regard to this subsection) shall not exceed 50 percent of the value of the adjusted gross estate, as defined in paragraph (2).

* * * * * *

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

SEC. 20.2056(b)-5. *Marital deduction; life estate with power of appointment in surviving spouse.*

(a) *In general.* Section 2056(b)(5) provides that if an interest in property passes from the decedent to his surviving spouse (whether or not in trust) and the spouse is entitled for life to all the income from the entire interest or all the income from a specific portion of the entire interest, with a power in her to appoint the entire interest or the specific portion, the interest which passes to her is a deductible interest, to the extent that it satisfies all five of the conditions set forth below (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the interest):

(1) The surviving spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from frequent intervals.

(2) The income payable to the surviving spouse must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

(b) *Specific portion; deductible amount.* If either the right to income or the power of appointment passing to the surviving spouse pertains only to a specific portion of a property interest passing from the decedent, the marital deduction is allowed only to the extent that the rights in the surviving spouse meet all of the five conditions described in paragraph (a) of this section. While the rights over the income and the power must coexist as to the same interest in property, it is not necessary that the rights over the income or the power as to such interest be in the same proportion. However, if the rights over income meeting the required conditions set forth in paragraph (a)(1) and (2) of this section extend over a smaller share of the property interest than the share with respect to which the power of appointment requirements set forth in paragraph (a)(3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Correspondingly, if a power of appointment meeting all the requirements extends to a smaller portion of the property interest than the portion over which the income rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the decedent leaves to his surviving spouse the right to receive annually all of the income from a particular property interest and a power of appointment meeting the specifications prescribed in paragraph (a)(3) through (5) of this section as to only one-half of the property inter-

est, then only one-half of the property interest is treated as a deductible interest. Correspondingly, if the income interest of the spouse satisfying the requirements extends to only one-fourth of the property interest and a testamentary power of appointment satisfying the requirements extends to all of the property interest, then only one-fourth of the interest in the spouse qualifies as a deductible interest. Further, if the surviving spouse has no right to income from a specific portion of a property interest but a testamentary power of appointment which meets the necessary conditions over the entire interest, then none of the interest qualifies for the deduction. In addition, if, from the time of the decedent's death, the surviving spouse has a power of appointment meeting all of the required conditions over three-fourths of the entire property interest and the prescribed income rights over the entire interest, but with a power in another person to appoint one-half of the entire interest, the value of the interest in the surviving spouse over only one-half of the property interest will qualify as a deductible interest.

(c) *Definition of "specific portion"*. A partial interest in property is not treated as a specific portion of the entire interest unless the rights of the surviving spouse in income and as to the power constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to one-half or a specified percentage of the property, or the equivalent, the interest is considered as a specific portion. On the other hand, if the annual income of the spouse is limited to a specific sum, or if she has

a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest. Even though the rights in the surviving spouse may not be expressed in terms of a definite fraction or percentage, a deduction may be allowable if it is shown that the effect of local law is to give the spouse rights which are identical to those she would have acquired if the size of the share had been expressed in terms of a definite fraction or percentage. The following examples illustrate the application of this and the preceding paragraphs of this section:

Example (1). The decedent transferred to a trustee 500 identical shares of X Company stock. He provided that during the lifetime of the surviving spouse the trustee should pay her annually one-half of the trust income or $6,000, whichever is the larger. The spouse was also given a general power of appointment, exercisable by her last will over the sum of $160,000 or over three-fourths of the trust corpus, whichever should be of larger value. Since there is no certainty that the trust income will not vary from year to year, for purposes of paragraphs (a) and (b) of this section, an annual payment of a specified sum, such as the $6,000 provided for in this case, is not considered as representing the income from a definite fraction or a specific portion of the entire interest if that were the extent of the spouse's interest. However, since the spouse is to receive annually at least one-half of the trust income, she will, for purposes of paragraphs (a) and (b) of this section, be considered as receiving all of the income from one-half of the entire interest in the stock. Inasmuch as there is no certainty that the value of the stock will be the same on the date of the surviving spouse's death as it was on the date of the decedent's death, for purposes of paragraphs (a) and (b) of this section, a specified sum, such as the $160,000 provided for in this case, is not considered to be a

definite fraction of the entire interest. However, since the surviving spouse has a general power of appointment over at least three-fourths of the trust corpus, she is considered as having a general power of appointment over three-fourths of the entire interest in the stock.

Example (2). The decedent bequeathed to a trustee an office building and 250 identical shares of Y Company stock. He provided that during the lifetime of the surviving spouse the trustee should pay her annually three-fourths of the trust income. The spouse was given a general power of appointment, exercisable by will, over the office building and 100 shares of the stock. By the terms of the decedent's will the spouse is given all the income from a definite fraction of the entire interest in the office building and in the stock. She also has a general power of appointment over the entire interest in the office building. However, since the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to appoint 100 shares at the time of the surviving spouse's death is not the same necessarily as a power to appoint 100/250 of the entire interest which the 250 shares represented on the date of the decedent's death. If it is shown in this case that the effect of local law is to give the spouse a general power to appoint not only the 100 shares designated by the decedent but also 100/250 of any shares or amounts which are distributed by the corporation and included in the corpus, the requirements of this paragraph will be satisfied and the surviving spouse will be considered as having a general power to appoint 100/250 of the entire interest in the 250 shares.

(d) *Definition of "entire interest".* Since a marital deduction is allowed for each qualifying separate interest in property passing

from the decedent to his surviving spouse (subject to the percentage limitation contained in §§ 20.2056(c)–1 and 20.2056(c)–2 concerning the aggregate amount of the deductions), for purposes of paragraphs (a) and (b) of this section, each property interest with respect to which the surviving spouse received some rights is considered separately in determining whether her rights extend to the entire interest or to a specific portion of the entire interest. A property interest which consists of several identical units of property (such as a block of 250 shares of stock, whether the ownership is evidenced by one or several certificates) is considered one property interest, unless certain of the units are to be segregated and accorded different treatment, in which case each segregated group of items is considered a separate property interest. The bequest of a specified sum of money constitutes the bequest of a separate property interest if immediately following distribution by the executor and thenceforth it, and the investments made with it, must be so segregated or accounted for as to permit its identification as a separate item of property. The application of this paragraph may be illustrated by the following examples:

Example (1). The decedent transferred to a trustee three adjoining farms, Blackacre, Whiteacre, and Greenacre. His will provided that during the lifetime of the surviving spouse the trustee should pay her all of the income from the trust. Upon her death, all of Blackacre, a one-half interest in Whiteacre, and a one-third interest in Greenacre were to be distributed to the person or persons appointed by her in her will. The surviving spouse is considered as being entitled to all of the income from the entire interest in Blackacre, all of the income from the entire interest in Whiteacre, and all of the income from the entire interest in Greenacre. She also is considered as hav-

ing a power of appointment over the entire interest in Blackacre, over one-half of the entire interest in Whiteacre, and over one-third of the interest in Greenacre.

Example (2). The decedent bequeathed $250,000 to C, as trustee. C is to invest the money and pay all of the income from the investments to W, the decedent's surviving spouse, annually. W was given a general power, exercisable by will, to appoint one-half of the corpus of the trust. Here, immediately following distribution by the executor, the $250,000 will be sufficiently segregated to permit its identification as a separate item, and the $250,000 will constitute an entire property interest. Therefore, W has a right to income and a power of appointment such that one-half of the entire interest is a deductible interest.

Example (3). The decedent bequeathed 100 shares of Z Corporation stock to D, as trustee. W, the decedent's surviving spouse, is to receive all of the income of the trust annually and is given a general power, exercisable by will, to appoint out of the trust corpus the sum of $25,000. In this case the $25,000 is not, immediately following distribution, sufficiently segregated to permit its identification as a separate item of property in which the surviving spouse has the entire interest. Therefore, the $25,000 does not constitute the entire interest in a property for the purpose of paragraphs (a) and (b) of this section.

(e) *Application of local law.* In determining whether or not the conditions set forth in paragraph (a)(1) through (5) of this section are satisfied by the instrument of transfer, regard is to be had to the applicable provisions of the law of the jurisdiction under which the interest passes and, if the transfer is in trust, the applicable provisions of the law governing the administration of the trust. For example, silence of a trust instrument as to the frequency

of payment will not be regarded as a failure to satisfy the condition set forth in paragraph (a)(2) of this section that income must be payable to the surviving spouse annually or more frequently unless the applicable law permits payment to be made less frequently than annually. The principles outlined in this paragraph and paragraphs (f) and (g) of this section which are applied in determining whether transfers in trust meet such conditions are equally applicable in ascertaining whether, in the case of interests not in trust, the surviving spouse has the equivalent in rights over income and over the property.

(f) *Right to income.* (1) If an interest is transferred in trust, the surviving spouse is "entitled for life to all of the income from the entire interest or a specific portion of the entire interest," for the purpose of the condition set forth in paragraph (a)(1) of this section, if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the decedent's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the surviving spouse during her life such an income, or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment. In determining whether a trust

evidences that intention, the treatment required or permitted with respect to individual items must be considered in relation to the entire system provided for the administration of the trust.

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SEC. 20.2056(b)–6. *Marital deduction; life insurance or annuity payments with power of appointment in surviving spouse.*

(a) *In general.* Section 2056(b)(6) provides that an interest in property passing from a decedent to his surviving spouse, which consists of proceeds held by an insurer under the terms of a life insurance, endowment, or annuity contract, is a "deductible interest" to the extent that it satisfied all five of the following conditions (see paragraph (b) of this section if one or more of the conditions is satisfied as to only a portion of the proceeds):

(1) The proceeds, or a specific portion of the proceeds, must be held by the insurer subject to an agreement either to pay the entire proceeds or a specific portion thereof in installments, or to pay interest thereon, and all or a specific portion of the installments or interest payable during the life of the surviving spouse must be payable only to her.

(2) The installments or interest payable to the surviving spouse must be payable annually, or more frequently, commencing not later than 13 months after the decedent's death.

(3) The surviving spouse must have the power to appoint all or a specific portion of the amounts so held by the insurer to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The amounts or the specific portion of the amounts payable under such contract must

not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.

(b) *Specific portion; deductible interest.* If the right to receive interest or installment payments or the power of appointment passing to the surviving spouse pertains only to a specific portion of the proceeds held by the insurer, the martial deduction is allowed only to the extent that the rights of the surviving spouse in the specific portion meet the five conditions described in paragraph (a) of this section. While the rights to interest, or to receive payment in installments, and the power must coexist as to the proceeds of the same contract, it is not necessary that the rights to each be in the same proportion. If the rights to interest meeting the required conditions set forth in paragraph (a)(1) and (2) of this section extend over a smaller share of the proceeds than the share with respect to which the power of appointment requirements set forth in paragraph (a) (3) through (5) of this section are satisfied, the deductible interest is limited to the smaller share. Similarly, if the portion of the proceeds payable in installments is a smaller portion of the proceeds than the portion to which the power of appointment meeting such requirements relates, the deduction is limited to the smaller portion. In addition, if a power of appointment meeting all the requirements extends to a smaller portion of the proceeds than the portion over which the interest or installment rights pertain, the deductible interest cannot exceed the value of the portion to which such power of appointment applies. Thus, if the contract provides that the insurer is to retain the entire proceeds and pay all of the interest thereon annually to the surviving spouse and if the surviving spouse has a power of appointment meeting the specifications pre-

scribed in paragraph (a)(3) through (5) of this section, as to only one-half of the proceeds held, then only one-half of the proceeds may be treated as a deductible interest. Correspondingly, if the rights of the spouse to receive installment payments or interest satisfying the requirements extend to only one-fourth of the proceeds and a testamentary power of appointment satisfying the requirements of paragraph (a)(3) through (5) of this section extends to all of the proceeds, then only one-fourth of the proceeds qualifies as a deductible interest. Further, if the surviving spouse has no right to installment payments (or interest) over any portion of the proceeds but a testamentary power of appointment which meets the necessary conditions over the entire remaining proceeds, then none of the proceeds qualifies for the deduction. In addition, if, from the time of the decedent's death, the surviving spouse has a power of appointment meeting all of the required conditions over three-fourths of the proceeds and the right to receive interest from the entire proceeds, but with a power in another person to appoint one-half of the entire proceeds, the value of the interest in the surviving spouse over only one-half of the proceeds will qualify as a deductible interest.

(c) *Applicable principles.* (1) The principles set forth in paragraph (c) of § 20.2056(b)–5 for determining what constitutes a "specific portion of the entire interest" for the purpose of section 2056(b)(5) are applicable in determining what constitutes a "specific portion of all such amounts" for the purpose of section 2056(b)(6). However, the interest in the proceeds passing to the surviving spouse will not be disqualified by the fact that the installment payments or interest to which the spouse is entitled or the amount of the proceeds over which

the power of appointment is exercisable may be expressed in terms of a specific sum rather than a fraction or a percentage of the proceeds provided it is shown that such sums are a definite or fixed percentage or fraction of the total proceeds.

(2) The provisions of paragraph (a) of this section are applicable with respect to a property interest which passed from the decedent in the form of proceeds of a policy of insurance upon the decedent's life, a policy of insurance upon the life of a person who predeceased the decedent, a matured endowment policy, or an annuity contract, but only in case the proceeds are to be held by the insurer. With respect to proceeds under any such contract which are to be held by a trustee, with power of appointment in the surviving spouse, see § 20.2056(b)–5. As to the treatment of proceeds not meeting the requirements of § 20.2056(b)–5 or of this section, see § 20.2056(a)–2.

(3) In the case of a contract under which payments by the insurer commenced during the decedent's life, it is immaterial whether or not the conditions in subparagraphs (1) through (5) of paragraph (a) of this section were satisfied prior to the decedent's death.

(d) *Payments of installments or interest.* The conditions in subparagraphs (1) and (2) of paragraph (a) of this section relative to the payments of installments or interest to the surviving spouse are satisfied if, under the terms of the contract, the spouse has the right exercisable annually (or more frequently) to require distribution to herself of installments of the proceeds or a specific portion thereof, as the case may be, and otherwise such proceeds or interest are to be accumulated and held by the insurer pursuant to the terms of the contract. A contract which otherwise requires the insurer to make annual or more frequent pay-

ments to the surviving spouse following the decedent's death, will not be disqualified merely because the surviving spouse must comply with certain formalities in order to obtain the first payment. For example, the contract may satisfy the conditions in subparagraphs (1) and (2) of paragraph (a) of this section even though it requires the surviving spouse to furnish proof of death before the first payment is made. The condition in paragraph (a)(1) of this section is satisfied where interest on the proceeds or a specific portion thereof is payable, annually or more frequently, for a term, or until the occurrence of a specified event, following which the proceeds or a specific portion thereof are to be paid in annual or more frequent installments.

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